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EUR FOR DAS BRYZA

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SUBJECT: BULGARIANS CHAFE AT RUSSIAN HARD LINE IN B-A
PIPELINE TALKS

REF: SOFIA 1023

Classified By: DCM Alex Karagiannis for reasons 1.4 (b) and (d).

11. (C) Summary: Bulgarian government officials are expressing public and private disdain for two Russian proposals tabled during August 27-28 negotiations for the Burgas-Alexandropolous Pipeline (B-A) in Athens. The proposals would require Bulgaria and Greece, as minority shareholders in B-A, to either give up their decision-making rights in the pipeline corporation in return for guarantees from Russia to fill the pipeline, or take on the responsibility of filling 49 percent of the pipeline capacity themselves. Bulgarian officials claim that both proposals violate the terms of the Intergovernmental Agreement on B-A, signed March 15 in Athens - a charge the Bulgarians' U.S. legal advisors and Chevron on-lookers privately dispute. Unwilling to give up decision-making capability, the Bulgarians tell us they now plan to approach Kazmunaigas and Chevron in attempts to obtain commitments for their share of the pipeline capacity. At the same time, all our interlocutors are now questioning the future prospects of this pipeline. End Summary.

A HEATED RETURN FROM ATHENS

12. (C) Even before he returned from Athens, the lead Bulgarian negotiator, Stefan Gunchev, CEO of Burgas-Alexandropolous Bulgaria and an official of the Ministry of Regional Development, gave interviews to the Bulgarian media accusing the Russian side of bad faith negotiations and questioning the future of B-A itself. In a meeting with polecoffs upon his return on August 31, Gunchev described Russian behavior during the negotiations as "aggressive" and "out of line." He admitted the Bulgarian side was caught off guard by Russia's two proposals - that the Bulgarians and Greeks either give up their decision-making rights in the pipeline in return for Russia "undertaking" to fill 100 percent of the pipeline's capacity, or guarantee to fill 49 percent of the pipeline capacity themselves. He said both proposals violate article five of the Intergovernmental Agreement on B-A, under which, in the Bulgarians' interpretation, the Russian side will be responsible for filling the pipe. (Note: Our reading of the agreement casts doubt on this interpretation.)

13. (C) Unwilling to give up its decision-making rights in the pipeline, Gunchev told us that Bulgaria will now approach Chevron and Kazmunaigaz to obtain commitments to fill Bulgaria's 24.5 percent of the pipe by allowing these firms to purchase capacity "at preferential terms." (Note: Bulgaria's Foreign Minister was in Kazakhstan on September 3 and energy issues were high on his agenda. Initial reports

indicate Kazakhstan may be open to oil sales, but the practical questions of pricing and transit are huge.) Gunchev said Bulgaria and Greece had agreed to stand firm in the face of Russian proposals. On September 3, the two countries sent a joint protocol (which Gunchev gave us) to the Russians, stating clearly they do not believe minority rights should be linked with capacity allocation issues. In response, the Russian side sent a "points of contention" document to the Bulgarian and Greek delegations. Tellingly, the Russians' first point states: The aim of the pipeline construction is not profit maximization but transportation through the territory of Greece and Bulgaria, which will strengthen the geopolitical role of these countries in the region, create jobs and bring income taxes to their budgets."

ARE THE RUSSIANS OUT-OF-LINE?

¶4. (C) The U.S. attorneys advising the Bulgarians on B-A, tell us the Russian proposals should not have caught Bulgaria by surprise. Mark Lewis a pipeline lawyer from the U.S. firm Paul Hastings, who attended the negotiations in Athens, told us August 31 that in a side-bar meeting, the Russians told him they were seeking decision making rights only on "operational" issues, not on all issues, in return for Russian guarantees on input. Lewis said the sides agreed to continue meetings at the "legal adviser level" and in this forum Lewis plans to pursue Russia's flexibility on this count. On the second Russian proposal, Lewis worried that even if Bulgaria contracted with Chevron and Kazmunaigaz for oil input, there are no guarantees that Russia would actually allow such oil to make it out of the port of Novorosisk and to the pipeline. The Bulgarian side will need guarantees from Russia stating that contractual volumes will actually get on the ships headed to Burgas. Lewis stressed that

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despite the harsh rhetoric coming from the Bulgarian side after the meetings, the Bulgarians have not said no to anything. Ultimately, he believes the Bulgarians will be willing to give up some level of operational control to be relieved of the responsibility of filling the pipeline.

¶5. (C) According to Chevron, Russia's negotiating stance makes economic sense. According to Mark Woloshyn of Chevron's B-A team, the Bulgarians and Greeks have exaggerated expectations. Without oil, he told us, these countries cannot expect to have ownership and decision-making rights in the pipeline while also collecting transit tariffs. Woloshyn expressed doubts that Bulgaria would be able to contract with Chevron and Kazmunaigaz at rates that would be economically competitive with other available transit options. He noted that the Bulgarians have not contacted Chevron since the Athens meetings.

WHO REALLY WANTS/NEEDS THIS PIPELINE MOST?

¶6. (C). Gunchev told us that Bulgaria would like to see this pipeline completed, but not at any cost. He expressed doubts that this pipeline is a priority for the Russians, and said he would not be surprised if the Russians walked away from the project. In Lewis' view, this pipeline, as its first such project in the EU, is more important for the Russians than anyone else. But the Russians will not go ahead unless the other Bosphorus shippers (Kazmunaigas and Chevron) are involved. He added that the Bulgarian and Greek interest in the project is all financial, since they have no oil and the pipeline itself will offer few jobs. According to Chevron, the only person who really wants this pipeline is President Putin himself. According to Woloshyn, the project makes little economic sense, and consequently, neither of the two factors needed for the pipeline's success - financing and oil supplies - are certain. Chevron only wants in to secure Russian approval of CPC expansion. Woloshyn predicts the Russians will make intense efforts to make progress on the pipeline before Putin's term expires. If these efforts do

not succeed, B-A may be scrapped altogether, he suggested.

17. (C) Comment: By all accounts, the next few months will be critical (again) for the future of the Burgas-Alexandropolous pipeline. The Bulgarians (and Greeks) have taken a tough negotiating stance, which the economics of the project may not ultimately support. Public Bulgarian complaints about what they call unreasonable Russian demands may end up hurting those officials now making those claims, if, ultimately, the government decides to give up any amount of decision-making control in exchange for Russian assurances to fill the pipeline. If the Russians are truly under pressure to make progress on the pipeline before the end of Putin's term, the tough Bulgarian and Greek stance may buy these parties some leverage for which the economics of the project would not ordinarily allow.

18. (C) Comment Continued: Beyond the economics of oil and pipelines, there are politics and psychology. The Bulgarians are again chafing at what they perceive as Russia's heavy-handed approach. The prime minister's chief of staff did not dispute a characterization of "unremitting Russian pressure" in describing the latest round of talks. Indeed, the Bulgarians are familiar with the tactic of intense pressure followed by a more accommodating line designed to wear down resistance to Russian demands. With an energy novice at the helm of the Economics and Energy Ministry, and knowing the Russians hold a strong bargaining hand, our Bulgarian contacts are uncertain of next steps or genuine options. For now at least, they are holding their ground. We are confident they would welcome more briefings and discussions with U.S. experts as they define their position.

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